

Message Text

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ACTION EUR-12

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SUBJECT: SASKATCHEWAN S NEW OIL WELL INCOME TAX

REF: OTTAWA 10419#

1. SUMMARY: GOVERNMENT OF SASKATCHEWAN (GOS) HAS PUBLISHED REGULATIONS FOR NEW OIL WELL INCOME TAX 8 (BILL 47) WHICH REPLACES OIL AND GAS CONSERVATION, STABILIZATION AND DEVELOPMENT ACT OF 1973 (BILL 42) VOIDED BY CANADIAN SUPREME COURT IN DEC 1977. ALTHOUGH BOTH GOS AND CANADIAN PETROLEUM ASSOCIATION (CPA) HAVE CONSULTED ON NEW REGULATIONS, BILL 47 WILL BE AN ACCOUNTANT S NIGHTMARE AND BOTH SIDES ARE SEEKING AN ALTERNATIVE SOLUTION. END SUMMARY

2. AS STATED IN REFTTEL, GOS AND CPA HAVE QUIETLY CONSULTED OVER STRUCTURE OF NEW TAX SINCE LAST DECEMBER. ACTUAL TAX RATE, HOWEVER, WAS DETERMINED SOLELY BY GOS. BILL 42 PROVIDED FOR ROYALTY SYSTEM BASED ON QUANTITY OF OIL PRODUCED, WHILE BILL 47 USES A COMPLICATED FORMULA TO DETERMINE TAX TO BE PAID ON NET INCOME OF OIL PRODUCED BY EACH WELL OR UNIT OF PRODUCTION. BILL 47 IS RETROACTIVE IN EFFECT TO JAN 1, 1974 AND COVERS THE ENTIRE PERIOD BILL 42 TAXES
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WERE PAID.

3. BILL 47 TAX RATES ARE AS FOLLOWS: 80 PERCENT FOR THE 1974 CALENDAR YEAR, 77 PERCENT FOR 1975 AND 1976, 70 PERCENT FOR 1977, AND 60 PERCENT FOR 1978. MAJOR DEDUCTIONS PERMITTED INCLUDE: OPERATING EXPENSES, EXPLORATION AND DEVELOPMENT, CAPITAL EXPENDITURES,

AND WELL DRILLING COSTS (CAPITAL EXPENDITURES AND WELL DRILLING COSTS ARE TO BE DEPRECIATED OVER TIME). ALSO FACTORED INTO THE TAX DEDUCTIONS IS A SPECIAL OVERHEAD ADMINISTRATION ALLOWANCE: DOLS 90 PER MONTH IN 1974, DOLS 100 IN 1975, DOLS 110 IN 1976. DOLS 120 IN 1977, AND DOLS 130 PER MONTH IN 1978.

4. GOS WILL NOT ASSESS DOUBLE TAXATION ON OIL WELLS PRODUCING ON CROWN LAND. THIS PRODUCTION IS SUBJECT TO A ROYALTY WHICH IS CONSIDERED AN INCOME TAX CREDIT. IN 1974 APPROXIMATELY 60 PERCENT OF PRODUCTION WAS ON CROWN LAND AND 40 PERCENT ON FREEHOLD LAND. TODAY APPROXIMATELY 85 PERCENT IS ON CROWN LAND AND ONLY 15 PERCENT ON FREEHOLD.

5. BOB MONCUR, DEPUTY MINISTER OF MINERAL RESOURCES, AND BILL SPICER,

MANAGER OF THE SASKATCHEWAN DIVISION OF CPA BOTH STATED IN SEPARATE INTERVIEWS WITH CONOFF THAT EXTENSIVE AND CORDIAL CONSULTATIONS HAVE OCCURRED BETWEEN GOS AND CPA SINCE LAST DECEMBER. HOWEVER, BOTH ALSO STATED THE TAX IS EXTREMELY COMPLICATED. MONCUR SAID GOS WILL HAVE TO EMPLOY SEVERAL MORE ACCOUNTANTS TO HANDLE THE PAPERWORK AND SPICER LABELED THE TAX "ONE HORRENDOUS ACCCOUNTING NIGHTMARE."

6 SPICER INFORMED CONOFF THAT IT WILL PROBABLY BE MONTHS BEFORE OIL UNCLASSIFIED

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COMPANIES KNOW WHAT THE EFFECTIVE TAX RATE WILL BE, BUT HIS PRELIMINARY ANALYSIS OF THE RETROACTIVE PORTION OF THE TAX IS THAT IT IS DESIGNED TO RECOVER BOTH THE PRINCIPAL AND INTEREST OF THE OLD ROYALTY SYSTEM.

7. CPA HAS FORMALLY REQUESTED ON BEHALF OF THE INDIVIDUAL COMPANIES THAT GOS CONSIDER INSTITUTING A CONTRACTUAL AGREEMENT WITH EACH COMPANY AS AN ALTERNATIVE TO THE TAX. PREMIER BLAKENEY HAS EXPRESSED

INTEREST IN SUCH AN ARRANGEMENT. MONCUR INDICATED THE CONTRACTS WOULD HAVE TO COVER BOTH RETROACTIVE AND FUTURW SPAYMENTS. EACH COMPANY WOULD ALSO HAVE TO AGREE THAT IT WILL NOT CHALLENGE THE CONTRACT IN COURT.

8. GOS IS DRAWING UP A MODEL CONTRACTUAL AGREEMENT NOW FOR SUBMISSION TO CPA, THERE ARE BETWEEN 150 AND 200 OIL PRODUCERS IN SASKATCHEWAN. HOWEVER, 21 OF THESE CONTROL OVER 90 PERCENT OF THE

OIL PRODUCTION. MONCUR BELIEVES THAT IF TWO-THIRDS TO THREE-QUARTERS OF THESE MAJOR COMPANIES OPT FOR THE CONTRACTUAL AGREEMENT, THEN ALL WILL. HE BELIEVES A DECISION WILL BE REACHED BY THE END

OF OCTOBER OR BEGINNING OF NOVEMBER. SPICER SUPPORTED THIS, STATING THAT ALTHOUGH BILL 47 IS THE BEST OF A BAD SITUATION, THE ONLY WAY THE COMPANIES CAN AVOID BEING ENGULFED IN PAPER WORK IS TO OBTAIN A SIMPLE CONTRACTUAL ARRANGEMENT WITH GOS WHICH WILL PERMIT THEM TO PAY FEES SIMILAR TO ROYALTY PAYMENTS.

9. BOTH MONCUR AND SPICER STATED BOTH SIDES ARE CONCILIATORY AND ARE SEEKING BEST SOLUTION TO DIFFICULT PROBLEM. MONCUR SAID THAT ALTHOUGH COMPANIES WERE OPPOSED TO ROYALTY PAYMENTS WHEN INSTITUTED IN 1974, BY 1977 THEY WERE RECONCILED TO THE PAYMENTS AND THEY NOW FIND THAT ROYALTY PAYMENTS ARE EASIER TO LIVE WITH THAN AN INCOME TAX. FOR HIS PART SPICER SAID THE GOS IS NO LONGER AS RADICAL AS IT WAS IN 1974 AND IS NOW RESIGNED TO HAVING PRIVATE COMPANIES PARTICIPATE IN OIL EXPLORATION AND EXTRACTION IN SASKATCHEWAN.
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10. COPIES OF BILL 47 REGULATIONS HAVE BEEN POUCHED TO DEPARTMENT AND OTTAWA.
CARPENTER

NOTE BY OC/T: REFERENCE AS RECEIVED.

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